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SUBJECT: LATVIA'S 2008 BUDGET

REFTEL: RIGA 852

¶1. Summary: On November 8th, the Saeima (Parliament) passed the government's 2008 budget, with 54 parliament members voting in favor and 39 against. In line with the main budgetary priority, which was economic stabilization in the face of accelerating inflation, the budget plans to run a 1% of GDP surplus (Latvian Lats (LVL) 163 million, \$341 million USD). Revenue next year is projected to be LVL 5.498 billion (\$11.5 billion USD), while expenditures are planned to total LVL 5.335 (\$11.2 billion USD). Demonstrations took place outside the parliament building on the day of the last reading, with health care workers, teachers and pensioners rallying against the proposed budget and calling for salary and social security payment increases. The media, several politicians and other sources have called the new budget a compromise plan, as it attempts to establish a balance between fiscal restraint and additional funding for worker compensation. End summary.

¶2. The new budget provides less additional funding for worker compensation than what was officially sought by various labor groups. The Health and Social Care Workers Labor Union was especially dissatisfied, denouncing the budget and declaring that it is planning to take legal action against the government for failing to act in accordance with a previous agreement.

¶3. The ruling coalition in the parliament rejected all opposition proposals on the budget, including a proposal to decrease funding for Latvia's military forces. In all, nearly LVL 305 million (\$638 million USD) was allocated to the National Defense, Security and NATO Integration program. Ninety-one percent (or approximately LVL 278 million, \$582 million USD) of those funds were assigned to the Ministry of Defense.

¶4. The budget also establishes a new fiscal tool, by creating a long-term economic stabilization reserve. The budget law stipulates that all revenue exceeding base-budget spending, and revenue generated from privatizations, shall be transferred to the fund.

¶5. Comment: Growing inflation remains the central macroeconomic issue in Latvia. Several economists have suggested that, with the inflation rate in double digits, the government should have planned for an even larger surplus and established incentives aimed at raising the competitiveness of Latvian businesses. In their minds, increasing competitiveness should be the topmost priority and would be the best way to reduce the future risk of a severe economic downturn due to high inflation. The budget's mix of moderate salary increases and enough spending constraints to create an overall surplus represents a compromise budget between various factions and interests. However, with inflation running at 13.2% (reftel), it remains to be seen if a 1% of GDP surplus will be enough to curtail inflationary pressures.